90-1709

Supreme Court, U.S.
FILED
MAY 1 1991
OFFICE OF THE CLERK

No. _____

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1991

IN RE JEHAN-DAS, INC.,

Debtor.

JEHAN-DAS, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA
and INTERNAL REVENUE SERVICE,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Whether in a Chapter 11 bankruptcy proceeding, a corporation, as debtor-in-possession, has the right to direct allocation of tax payments from funds in its actual possession and control to the trust fund portion of withholding and FICA tax liabilities that accrued after the date of the filing of the bankruptcy petition.

PARTIES TO THE PROCEEDING

The names of all parties to this proceeding appear in the caption of the case. There is no parent or subsidiary corporation of the Petitioner.

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IN THE
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IN RE JEHAN-DAS, INC.,

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

Petitioner Jehan-Das, Inc., by counsel, respectfully petitions this Court for a Writ of Certiorari to review the Judgment of the United States Court

of Appeals for the Eighth Circuit in this case.

OPINIONS BELOW

The Opinion of the Eighth Circuit Court of Appeals (App. A) is reported at 925 F.2d 237. The Opinion of the United States District Court for the Western District of Missouri, Southern Division, (App. B, infra) is not reported. The Opinion of the United States Bankruptcy Court for the Western District of Missouri, Southern Division, (App. C) is reported at 91 B.R. 542.

JURISDICTION

The Judgment of the Court of Appeals (App. B, infra) was filed on February 1, 1991. This Petition is being timely filed pursuant to 28 U.S.C. Section 2101(c). This Court has jurisdiction pursuant to 28 U.S.C. Section 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. There are no constitutional provisions involved in this matter.

2. Several provisions of the Internal Revenue Code are involved in this matter and are set forth verbatim in Appendix D pursuant to Supreme Court Rule 14.1(f) and (k). They are:

a. 26 U.S.C.A. 3102(a).

b. 26 U.S.C.A. 6672(a).

c. 26 U.S.C.A. 6672(a).

d. 26 U.S.C.A. 7501(a).

STATEMENT OF THE CASE

The facts of this case are undisputed. On or about October 20, 1981 Jehan-Das, Inc., filed a voluntary petition pursuant to Chapter 11 of the United States Bankruptcy Code and relief was ordered. The corporation continued to do business as a Debtor-In-

Possession. No Plan was ever confirmed.

Business operations ceased sometime during 1984 and the bankruptcy estate was ultimately liquidated. Accountings filed by the Debtor-In-Possession on June 25, 1987 and July 23, 1987 show proceeds from the sale of estate assets in the sum of $59,000.00 plus accrued interest, which is available for distribution to creditors.

During the Chapter 11 proceedings the Debtor-In-Possession failed to pay post-petition, employment related taxes. The Internal Revenue Service (hereinafter IRS) filed a Request for Payment of Internal Revenue Taxes dated December 17, 1987, showing a total of $148,078.63 in unpaid withholding, FICA and FUTA taxes, which accrued subsequent to the filing of the Chapter 11 Petition. This figure includes interest

and penalties on the unpaid taxes as of the date of the request for payment. There has been no levy, distraint or actual seizure of funds by the IRS pursuant to any court or administrative action in this case. However, the actual amounts for withholding and FICA taxes constitute "trust fund taxes" pursuant to 26 U.S.C. Sections 3102(a) and 3402(a).

These trust fund taxes in the approximate amount of $57,345.52 have been assessed personally against the corporate president, John Royal, as a 100% penalty pursuant to 26 U.S.C. Section 6672. The IRS has filed a Notice Of Tax Lien in Tulsa County, Oklahoma, where Mr. Royal resides, for the trust fund portion of the corporate taxes personally assessed against him. No other action for collection of the

taxes in question has been initiated by the IRS.

Since it was unable to reorganize under Chapter 11, the Debtor-In-Possession filed a voluntary Motion To Dismiss and requested that the funds on hand be paid as a voluntary payment to the IRS with directions to apply those amounts first to the trust fund portion of the withholding and FICA taxes due. Such an application would reduce or eliminate John Royal's personal liability for the trust fund portions of the withholding and FICA taxes.

It is also likely that due to the accrual of interest on the sale proceeds, the excess, if any, would be available for application to the penalties and interest. The IRS has objected, not to being paid, but to the request by the Debtor-In-Possession

directing application of the funds to the trust fund taxes first.

The Bankruptcy Court initially denied the Debtor's request on the grounds the payment by the Debtor-In-Possession was involuntary. Both the United States District Court for the Western District of Missouri and the Eighth Circuit Court of Appeals affirmed this decision. Petitioner seeks review of these important questions of federal law in this Petition.

REASONS THE PETITION SHOULD BE GRANTED

I.

THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS IS IN CONFLICT WITH THE DECISIONS OF OTHER UNITED STATES COURTS OF APPEALS ON THE SAME MATTER AS TO WHAT CONSTITUTES A VOLUNTARY PAYMENT BY CORPORATE TAXPAYERS IN A CHAPTER 11 BANKRUPTCY PROCEEDING.

Federal law requires an employer to withhold social security and federal income taxes from the wages of their

employees. 26 U.S.C. Sections 3102(a) and 3402(a). These taxes are deemed to be held in a special fund and trust for the United States and are commonly referred to as "trust fund taxes". 26 U.S.C. Section 7501(a); Slodov v. United States, 436 U.S. 238 (1978).

Personal liability is imposed on corporate officers and directors who are "responsible persons" for the collection and payment of trust fund taxes. 26 U.S.C. Section 6672(a); Muntwyler v. United States, 703 F.2d 1030 (7th Cir. 1983). The interest, penalties and FUTA taxes are non-trust fund taxes for which they are not personally liable. In Re Technical Knockout Graphics, 833 F.2d 797 (9th Cir. 1987).

When a taxpayer makes a voluntary payment to the IRS it has the right, at the time of payment, to direct the

allocation of said payments to whatever type of liability it chooses. O'Dell v. United States, 326 F.2d 451 (10th Cir.1964); Muntwyler v. United States, supra. If the payment is not voluntary, it is the policy of the IRS to apply the payment received first to non-trust funds taxes to maximize tax collection. Matter of Ribs-R-Us, Inc., 828 F.2d 199 (3rd Cir. 1987).

Whether a payment is deemed to be "voluntary" or "involuntary" is determinative of the taxpayers right to direct allocation of payments for taxes. The cases have uniformly adopted the definition of involuntary payments annunciated in Amos v. Commissioner, 47 TC 65, 69 (1966), which provides as follows:

> An involuntary payment of federal taxes means any payment received by agents of the United States as a

> result of distraint or levy or from a legal proceeding in which the government is seeking to collect its delinquent taxes or file a claim therefore.

This definition was explained and further defined in Muntwyler v. United States, supra, at page 1033 where the Court states:

> The distinction between a voluntary and involuntary payment in Amos and all the other cases is not made on the basis of the presence of administrative action alone, but rather the presence of court action or administrative action resulting in an actual seizure of property or money as in a levy. No authorities support the proposition that a payment is involuntary whenever an agency takes even the slightest action to collect taxes, such as filing a claim or, as appears to be a logical extension of the government's position, telephoning or writing the debtor to inform him of taxes due. (emphasis in original).

The Court in Muntwyler declined to equate an assignment for the benefit of creditors with a bankruptcy proceeding. Id., note 2, page 1034. However, its

interpretation of the voluntary/ involuntary distinction has been cited with approval in many bankruptcy cases. Matter of Ribs-R-Us Inc., supra; Matter of Avildsen Tools & Machine, Inc., 794 F.2d 1248 (7th Cir. 1986). However, the circuit courts are in conflict as to whether tax payments by Chapter 11 debtors-in possession are voluntary.

The Third, Sixth and Ninth Circuits have adopted a per se rule holding that tax payments by Chapter 11 debtors-in-possession are involuntary. In Matter of Ribs-R-Us, Inc., supra, the Third Circuit held that payment of taxes by a debtor on pre-petition priority tax liabilities pursuant to a confirmed plan of reorganization are involuntary. the Court in In Re DuCharmes & Co., 852 F.2d 194 (6th Cir. 1988) found that payments made to the IRS on pre-petition tax

liabilities by a Chapter 11 debtor-in-possession ought to be considered involuntary payments. In lockstep, the Ninth Circuit has found tax payments by a debtor-in-possession after filing a voluntary Chapter 11 petition but prior to confirmation of a reorganization plan, are involuntary. In Re Technical Knockout Graphics, Inc., 833 F.2d 797 (9th Cir 1987).

To the contrary, the Eleventh Circuit has declined to adopt the per se rule that all tax payments made under a Chapter 11 reorganization are involuntary. Matter of A & B Air Conditioning, 823 F.2d 462 (11th Cir 1987) vacated and remanded, ___U.S.___, 108 S.Ct. 1724, 100 L.Ed. 2d 189 (1988) reinstated 861 F.2d 1538 (1988) remanded for dismissal as moot, 878 F.2d 1311 (11th Cir. 1989). The Eleventh Circuit

has found instead that the allocation question in a Chapter 11 bankruptcy case should be left to judicial discretion on a case by case basis in consideration of the following factors:

1. The history of the debtor.

2. The absence or existence of pre-bankruptcy collection or enforced collection measures of the IRS against the corporation and responsible corporate officers.

3. The nature and contents of a Chapter 11 plan (e.g. last resort liquidation or reorganization).

4. The presence, extent and nature of administrative and/or court actions.

5. The presence of pre-bankruptcy or post-bankruptcy agreements between the debtor (or trustee) and the IRS.

6. The existence of exceptional or special circumstances or equitable reasons warranting such allocation.

Id., 823 F.2d 462, 466, reinstated 861 F.2d 1538.

The First Circuit has likewise adopted the case by case approach. In Re Energy Resources Co., Inc., 871 F.2d 223 (1st Cir. 1989) aff'd. __U.S.__ 110 S.Ct. 2139, 109 L.Ed. 2d 580 (1990).

The Third, Sixth and Ninth Circuits have adopted a per se rule that tax payments by Chapter 11 debtors-in-possession are involuntary. In the case at bar the Eighth Circuit followed a middle course and found the payment in question was involuntary because the Debtor could not distribute the funds without court approval and had been ordered by the Bankruptcy Court to make the distribution to the IRS as the only administrative claimant. In Re Jehan-Das, Inc., 925 F.2d 237, 238 (8th Cir. 1991).

The First and Eleventh Circuits follow a case by case approach which allows that some tax payments by Chapter 11 debtors-in-possession may be voluntary. This conflict among the Circuit Courts of Appeal remains unresolved by this Court's decision in U.S. v. Energy Resources Co., Inc., __U.S.__, 110 S.Ct. 2139, 109 L.Ed. 2d 580 (1990). This decision ignores the crucial distinction between whether a payment is voluntary or involuntary and holds that a bankruptcy court may order the IRS to apply tax payments to off-set trust fund obligations where it concludes such action is necessary for a reorganization's success whether voluntary or not. Id., 110 S.Ct. at 2143. The Third, Sixth and Ninth Circuit decisions are also in conflict with the Seventh Circuit's decision in

Muntwyler v. U.S., supra, which holds that an actual seizure of the property or money is necessary to render the payment involuntary.

This conflict among the Circuit Courts of Appeal remains unresolved by this Court's decision in U.S. v. Energy Resources Co., Inc., __U.S.__, 110 S.Ct. 2139, 109 L.Ed. 2d 580 (1990). This decision ignores the crucial distinction between whether a payment is voluntary or involuntary. It holds that a bankruptcy court may order the IRS to apply tax payments to off-set trust fund obligations where it is necessary for a reorganization's success whether or not such payments are voluntary or involuntary. Id., 110 S.Ct. at 2143.

II.

THE QUESTION PRESENTED INVOLVES AN IMPORTANT QUESTION OF FEDERAL LAW AS TO WHAT CONSTITUTES A VOLUNTARY PAYMENT BY

CORPORATE TAXPAYERS IN A CHAPTER 11 BANKRUPTCY PROCEEDING WHICH HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT.

All of the cases previously cited involve allocation of post petition tax payments made on pre-petition tax liabilities. The case at bar involves post-petition tax payments on post-petition tax liabilities. Although it may be a distinction without a difference, it nevertheless presents a question not directly addressed by this or any other court.

Regardless of this distinction, whether a payment by a Chapter 11 debtor-in-possession is voluntary or involuntary is one that has not, but should be, settled by this Court. This case presents a set of circumstances that has, and will continue to reoccur with untold frequency. At present there

is no bright line identifying payments to the IRS in a Chapter 11 bankruptcy as voluntary or involuntary. In Re Jehan-Das, Inc., supra, p. 238 citing In Re Energy Resources Co., supra, p. 228. The case by case approach adopted by the First and Eleventh Circuits leads to confusion, uncertainty and a multiplicity of litigation over what constitutes a voluntary payment by Chapter 11 debtors-in-possession.

A uniform federal rule defining voluntary payments in Chapter 11 bankruptcies "so that debtors, creditors and the IRS will be able to know in advance whether the debtor can make such a designation and guide their decisions accordingly would be most advantageous. In Re Ribs-R-Us, Inc., supra, at page 202. Petitioner submits that the

definition set forth in Muntwyler v. U.S., supra would be preferred.

III.

THE DECISION OF THE EIGHTH CIRCUIT COURT OF APPEALS MISINTERPRETS AND MISAPPLIES THIS COURT'S DECISION IN U.S. V. ENERGY RESOURCES CO., INC., SUPRA, AND IS IN CONFLICT WITH THAT DECISION OF THIS COURT.

In the case at bar the Eighth Circuit decided that it was bound by a consideration of the factors enunciated by the First Circuit in In Re Energy Resources, Inc., supra, in determining the character of the tax payment as voluntary or involuntary. In Re Jehan-Das, Inc., supra at page 238. The Court concluded that the payment was involuntary because the Debtor-In-Possession was under the control and supervision of the Bankruptcy Court, that it could not distribute the funds without Court approval and that the

Bankruptcy Court had already ordered the distribution to be made to the IRS. Id.

This reasoning would make it impossible for any tax payment during a Chapter 11 bankruptcy to be voluntary. It is inconsistent with the case by case approach the Eighth Circuit itself purported to adopt and this Court's decision in U.S. v. Energy Resources Co., Inc., supra, which recognizes that the Bankruptcy Court has broad authority to approve any appropriate provision not inconsistent with Title 11 and broad authority to modify creditor-debtor relationships. Id., at page 2142.

Clearly the Eighth Circuit views the restrictions placed on a Chapter 11 debtor-in-possession by the Bankruptcy Code as factors rendering post petition tax payments involuntary. It is equally clear that this Court takes the position

that the broad equitable powers of the Bankruptcy Court in fact permit the conclusion that such payments may be voluntary. This more expansive view is more consistent with the realities of the Bankruptcy Code and is supported by many bankruptcy court decisions. See: In re Energy Resources, 59 B.r. 702 (Bkrtcy. D.Mass 1986) aff'd 871 F.2d 1358 (1st Cir. 1989); Matter of A & B Heating & Air Conditioning, 53 B.R. 54 (Bkrtcy. M.D.Fla. 1985) aff'd 823 F.2d 642 (11th Cir. 1987). This Court should resolve this inconsistency.

CONCLUSION

For the foregoing reasons, a Writ of Certiorari should issue to review the Judgment and Opinion of the United States Court of Appeals for the Eighth Circuit.

DATED: April 25, 1991.

Respectfully submitted,

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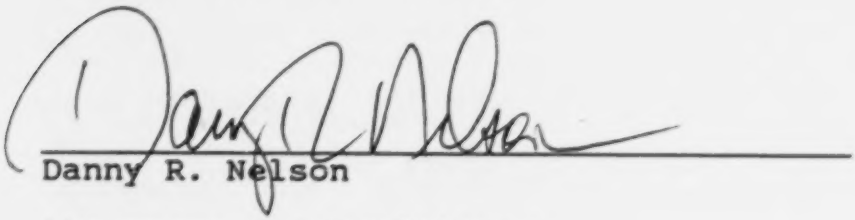

Danny R. Nelson

Attorneys for Petitioner

DRN:kaj

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

No. 89-1859WM

In Re: Jehan-Das, Inc.,	*	
Debtor,	*	
Jehan-Das, Inc.,	*	Appeal from the
	*	United States
Appellant,	*	District Court
	*	for the Western
v.	*	District of
	*	Missouri.
United States of America, and Internal Revenue Service,	*	
Appellees.	*	

Submitted: September 10, 1990

Filed: February 1, 1991

Before FAGG and BEAM, Circuit Judges, and WOODS,* District Judge.

FAGG, Circuit Judge.

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*The Honorable HENRY WOODS, United States District Judge for the Eastern District of Arkansas, sitting by designation.

The sole issue presented on appeal is whether Jehan-Das, Inc.'s payment of the proceeds from its liquidated bankruptcy estate to the Internal Revenue Service (IRS) in partial satisfaction of the IRS's administrative claim for post petition taxes is voluntary or involuntary. The bankruptcy court concluded the payment is involuntary. We affirm.

The controlling facts are undisputed. After Jehan-Das filed Chapter 11 bankruptcy in 1981, it incurred a substantial tax liability, including trust fund taxes for employees' personal income taxes and social security taxes. See 26 U.S.C. Sections 3102(a), 3402(a), 7501(a) (1988). The IRS assessed an amount equal to the trust fund portion of the

taxes against John Royal, president of Jehan-Das, as the responsible person. See id. Sections 6671(b), 6672. When Jehan-Das informed the bankruptcy court a reorganization was not feasible, the court supervised liquidation of the bankruptcy estate. The bankruptcy court then set a deadline for filing administrative claims and ordered Jehan-Das to distribute the liquidation funds in satisfaction of those claims. The IRS filed the only administrative claim, and because the funds available are insufficient to satisfy the entire claim, the IRS will be the only creditor to receive payment.

Despite the bankruptcy court's order that Jehan-Das distribute the liquidation funds to the IRS, Jehan-Das asked the court to designate its payment

to the IRS as voluntary. If the payment is voluntary, Jehan-Das can direct is application to trust fund taxes and relieve Royal of personal responsibility. See generally In re Energy Resources Co., 871 F.2d 223,227 (1st Cir. 1989), aff'd on other grounds, 110 S. Ct. 2139 (1990). If the payment is involuntary, however, the IRS will direct is application. Id. Typically, the IRS applies involuntary payments to non-trust fund taxes first, thus preserving its recourse to the responsible individual and enhancing its potential for collection of the full amount due. Id.

We conclude Jehan-Das's payment to the IRS is involuntary. There is no bright line identifying payments to the IRS as voluntary or involuntary. Id. at

228. Rather, we must consider the factors present to determine the character of the payment. Id. Jehan-Das liquidated its assets under the control and supervision of the bankruptcy court, see 11 U.S.C. Section 363(b)(1) (1988), and it cannot distribute the funds without court approval, see id. Section 503(b)(1)(B)(i). The bankruptcy court, in fact, has already ordered Jehan-Das to make the distribution to the IRS as the only administrative claimant. See id. Section 507(a)(1). The bankruptcy proceeding cannot be closed until Jehan-Das distributes the funds and reports tot eh court. See id. Section 350(a). Thus, Jehan-Das has no choice but to pay the funds to the IRS. Under these circumstances, the payment is involuntary.

Accordingly, we affirm.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

APPENDIX B

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MISSOURI
SOUTHERN DIVISION

In Re:
Jehan-Das, Inc.,
Debtor,

JUDGMENT IN A CIVIL CASE

Jehan-Das, Inc.,
Appellant,

v.

Case Number
89-3030-CV-S-2
(Filed May 8, 1989)

UNITED STATES OF AMERICA,
Appellee.

Decision by Court. This action came to determination before the Court. The issues have been determined and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that this Court finds that the debtor's payments to the IRS are involuntary and that the appellant corporation may not direct the IRS to apply

said payments first to its trust fund liability. The judgment of the Bankruptcy Code is therefore AFFIRMED.

Entered on May 8, 1989

May 8, 1989 R.F. Connor

Date Clerk

/s/Jamie J. McBurney

By Deputy Clerk

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF MISSOURI SOUTHERN DIVISION

In re:

Jehan-Das, Inc.,	)	
	)	
Debtor,	)	
	)	
Jehan-Das, Inc.,	)	No 89-3030-CV-S-2
	)	
Appellant.	)	Filed May 8, 1989
	)	
v.	)	
	)	
UNITED STATES OF AMERICA,	)	
	)	
Appellee.	)	

MEMORANDUM OPINION AND ORDER

The present matter is before the Court on appellant Jehan-Das, Inc.'s appeal from the judgment of the Bankruptcy Court for the Western District of Missouri.[1] On October 17, 1988, the Bankruptcy Court held that tax payments to be made by appellant Jehan-

[1]The Honorable Frank Koger, Judge, United States Bankruptcy Court for the Western District of Missouri.

Das, Inc. in its liquidating Chapter 11 bankruptcy were involuntary payments. As a result, the Bankruptcy Court held that the appellant could not direct the IRS to allocate the tax payments first to its trust fund liability thereby extinguishing the personal liability pursuant to 26 U.S.C. Section 6672 of the corporate president. the judgment is affirmed.

The parties have stipulated to the following facts as set forth in Judge Koger's memorandum opinion. Jehan-Das, Inc. filed a voluntary petition under Chapter 11 of the Bankruptcy Code on October 20, 1981. The corporation continued to do business as a debtor-in-possession. No plan was ever confirmed. Due to the debtor's inability to reorganize, business operations ceased during 1984 and the estate was

ultimately liquidated.

During the Chapter 11 proceedings, the debtor failed to pay post-petition, employment related taxes. Pursuant to a court order allowing the filing of claims, the Internal revenue Service (IRS) filed a Request for Payment of Internal Revenue Taxes dated December 19, 1987, showing a total of $148,078.63 including interest and penalties, in unpaid withholding, FICA and FUTA taxes which accrued subsequent to the filing of the Chapter 11 petition. The IRS Request for Payment also states additional late payment penalties after the date of said request accruing at the rate of $609.73 per month. For the nine months following the date of the filing of said request an additional $5,451.57 is due. Total taxes, interest, penalty

and late charges are, therefore, $153,530.20.

The amounts for withholding and FICA taxes have been assessed personally against the corporate president, as a 100% vested penalty pursuant to 26 U.S.C. Section 6672. John G. Royal was personally assessed liability for $36,111.23 for the taxable quarters ending December 31, 1981, through June 30, 1983 and a similar assessment was made on December 7, 1987, in the amount of $9,142.79 for the unpaid employees' portion of the debtor's employment tax liabilities for the taxable quarters ending September 30, 1983, through June 30, 1984. The IRS has filed a notice of tax lien for the trust fund portion of the corporate taxes assessed against John G. Royal in Tulsa County, Oklahoma.

The debtor filed a motion to dismiss in the bankruptcy court below and requested that the funds on hand be paid to theIRS with directions to apply the proceeds from the sale of the estate assets first to the trust fund portion of the withholding and FICA taxes due. The debtor's effort to direct the IRS to allocate the tax payments first to its trust fund liability would operate to reduce the amount collectible from John G. Royal, personally to the extent the tax payments are actually made by the debtor.

"The Internal Revenue Code provides that taxes such as withholding and social security taxes, which must be deducted by employers from the wages paid to employees, 'shall be held to be a special fund in trust for the United States.' 26 U.S.C. Section 7501(a)."

In re Ducharmes & Co. v. Michigan, 852 F.2d 194, 195-96 (6th Cir. 1988). These taxes are known as trust fund taxes. Non-trust fund taxes include corporate income taxes and the employer's share of social security taxes. "Under the Code, the employer is responsible for collecting, and is personally liable for the trust fund taxes. 26 U.S.C. Sections 3102(a),(b), 3402, 3403, 6672." In re Technical Knockout Graphics, Inc., 833 F.2d 797, 799 (9th Cir. 1987). the employer is not held personally liable when non-trust fund taxes are not collected and remitted to the United States government.

It is undisputed that when a delinquent taxpayer makes a voluntary payment to the IRS, the taxpayer may direct the IRS to allocate the tax payment to any amount owed. In re Ribs-

R-Us, 828 F.2d 199, 201 (3rd Cir. 1987). However, when a payment to the IRS is considered involuntary, the IRS may allocate the payment a it sees fit. In re Technical Knockout Graphics, supra, at 799. When a payment is not voluntary, it is the policy of the IRS to allocate the tax payment first to non-trust fund taxes due. In re Ribs-R-Us, supra, at 201. "Because the personal liability of the responsible person offers an additional source of collection of trust fund taxes, this allocation increases the United States' opportunity to recover taxes due it in full." Id. Consequently, the parties are in agreement that the issue posed by this appeal is the following:

> Within the context of a Chapter 11 reorganization, does a taxpayer have the right to direct allocation of tax payments to certain tax

liabilities, i.e., is such payment a voluntary or involuntary payment.

The appellant contends that tax payments are voluntary and that it may direct the IRS to allocate the funds first for payment of the trust fund taxes. The United States contends the tax payments are involuntary. As a result, the United States argues the IRS has the authority to apply the payment first to non-trust fund taxes due and look to the corporate president for payment of the trust fund taxes.

In his written opinion, Bankruptcy Judge Koger held that the payments to the IRS were involuntary and that the appellant had no right to allocate the funds first for payment of the trust fund taxes. Judge Koger acknowledged that there had been "no levy, distraint or actual seizure of funds by the IRS in

the case." He further found that there had been no agreement between the IRS and appellant concerning the payment of the taxes. He noted that no reorganization plan had been confirmed during the Chapter 11 proceedings and that the estate had been liquidated. He determined that the appellant had failed to demonstrate exceptional circumstances warranting appellant's allocation of the payments. He further found that the corporate president by designating funds be paid to eliminate his personal liability first was "breaching his fiduciary duty as a debtor-in-possession to the debtor corporation." Judge Koger further held the following:

> The best interest of the corporation would be to apply the funds to its non-trust fund liability first, leaving the IRS an alternative source for the trust fund debt. Royal is acting in his fiduciary capacity for the

> corporation and thus he has a conflict of interest between his own interest (reducing his personal liability) and the corporation's interest (having an alternative source to pay off its debts). Because of this conflict, this Court finds it inappropriate for Royal, individually, to be making the designation of payments for the corporate debtor, where there has never been a plan confirmed and other parties in interest have never been advised of debtor's intention and desire to extricate its former principal.

On appeal, the appellant contends that the payments to the IRS should be considered voluntary because there has not been an "actual seizure of the funds as a result of court action." Appellant further argues that the IRS "has done nothing more than assess the liability personally against the corporate president, file a notice of tax lien in Tulsa County, Oklahoma, and request payment of the taxes in the bankruptcy proceedings." The appellant contends

these IRS actions are insufficient to make the payment involuntary. Moreover, the appellant contends the Bankruptcy Court's involvement in the case has thus far been minimal and that the mere presence of court action does not render the payment involuntary. Finally, the appellant argues that Judge Koger's finding that allocation of the payments to the appellant's trust fund liability amounts to a conflict of interest between Mr. Royal and the corporation "has no application in the determination of whether a payment in voluntary or involuntary." Further, appellant denies there is a conflict between Mr. Royal's interest and the corporation's interest as payment of the trust fund taxes serves the corporation's interest in that the corporation will no longer be liable for penalties and interest.

The government on the other hand argues that "the presence of judicial action renders payments by a debtor involuntary." Further, the government contends that the payment to the IRS cannot be considered voluntary in light of the various restrictions imposed upon the debtor by the Bankruptcy Code.

Federal courts across the country have been called upon to consider whether payments made to the IRS by a debtor in bankruptcy are considered voluntary or involuntary. The eighth Circuit Court of Appeals, however, as yet has not addressed the issue. Until recently, the courts appeared to be hopelessly divided on the issue. Within the last year, however, three United States circuit courts have held that payments to the IRS by a debtor in bankruptcy are involuntary. See in re

DuCharmes & Co. v. Michigan, supra, and In re Ribs-R-Us, supra. Further an Eleventh Circuit Case holding that a bankruptcy court has the discretion to determine on a case-by-case basis whether the debtor may allocate tax payments in a Chapter 11 proceeding was recently vacated. See In The Matter of A & B Heating & Air Conditioning, Inc., 823 F.2d 462 (11th Cir. 1987), vacated and remanded for consideration of mootness questions, ____U.S.____, 108 S.Ct. 1724 (1988). Finally, In re Professional Technical Services, Inc., 80 B.R. 157 (Br. E.D.Mo. 1987) rev'd ____B.R.____ (E.D.Mo. 1988), a case relied upon by the appellant for the proposition that tax payments made to the IRS during a Chapter 11 proceeding should be considered voluntary was recently revered by the United States

District Court for the eastern District of Missouri.

The above-mentioned circuit court cases emphasize the many restrictions imposed upon the bankruptcy debtor by the Bankruptcy Code in support of the premise that tax payments made by a debtor in bankruptcy are involuntary. For example, the Ninth Circuit Court of Appeals in In re Technical Knockout Graphics, inc., supra, at 802, noted the following:

> Once a debtor files a bankruptcy petition, the property it then possesses, as well as funds acquired thereafter, become the property of the estate. 11 U.S.C. Section 541(a). The debtor-in-possession is not free to deal with this property as it chooses, but rather holds it in trust for the benefit of creditors, just as would a trustee. . . . The property is not held for the benefit of the responsible persons, who in this action, are not even parties. By filing a bankruptcy petition, the debtor enjoys the protection of an injunction barring secured and

> unsecured creditors from pursuing the debtor without court intervention. A debtor-in-possession is required to obtain the court's permission to make payments other than in the ordinary course of business, and notice of this must be given to creditors. . . . To approve a reorganization plan, the court must find that the proposed plan is "fair and equitable," meaning that the payment priorities of the Bankruptcy Code are met. . . .

As a result of the restrictions imposed upon the debtor by the statutory scheme, it is difficult for the Court to accept the appellant's argument that the payment at issue is voluntary. Further, in light of these many restrictions, this Court disagrees with the appellant's attempt to characterize the Bankruptcy Court's role in this Chapter 11 proceeding as being minimal. In fact it is well worth noting that the debtor determined a court order was necessary to authorize the allocation of the

payment to the trust fund taxes. See Matter of Mister Marvins, 48 B.R. 279, 281 (E.D. Mich. 1984).

Further, the circuit court opinions reject the appellant's argument that only payments resulting from an actual seizure of property, such as a levy, should be considered involuntary. For example, one of the opinions describes this argument as giving "too limited a construction to involuntary." See In re Ribs-R-Us, supra, at 202. This Court agrees with that assertion especially in this case where the debtor's tax liability accrued subsequent to the filing of the bankruptcy petition and the government was prevented form initiating collection proceedings by virtue of the automatic stay imposed by the Bankruptcy Court.

This Court agrees with the reasoning set forth in the In re Ribs-R-Us, Inc., In re Technical Knockout Graphics, Inc., and In re DuCharmes & Company, Inc. opinions. Further , we agree with the Third Circuit Court of Appeals in In Re Ribs-R-Us, supra, at 202, that a "uniform federal rule is preferable so that debtors, creditors, and the Internal Revenue Service will be able to know in advance whether the debtor can make such a designation and guide their decisions accordingly." Therefore, this Court finds that the debtor's payments to the IRS are involuntary and that the appellant corporation may not direct the IRS to apply said payments first to its trust fund liability. The judgment of the Bankruptcy Court is therefore AFFIRMED.

/s/ William R. Collinson
William R. Collinson
U.S. Senior District Judge

May 8, 1989

APPENDIX C

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MISSOURI

Jehan-Das, Inc.	)	Case No.
	)	89-03244-S-2-11
	)	Filed
	)	October 18, 1989
Debtor.	)	

JUDGMENT

This proceeding having come on for trial or hearing before the court, the Honorable Frank W. Koger, United States Bankruptcy Judge, presiding, and the issues having been duly tried or heard and a decision having been rendered,

IT IS ORDERED AND ADJUDGED:

that payments made by the debtor to the IRS are involuntary in this case, and therefore, the IRS may decide how the payments will be allocated and the debtor will not be allowed to direct the payments.

Copies of the foregoing to:

Gary A. Love
P.O. Box 486
Ozark, MO 65721

Teresa Hair
222 John Q. Hammons Pky. Suite 1200
Springfield, MO 65806

mr
UST

R.F. Connor
Clerk of the Bankruptcy Court

(Seal of the U.S. Bankruptcy Court)

Dated: October 18, 1988
By: Georgia Ann Tarwater

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MISSOURI
SOUTHERN DIVISION

IN RE:	)	
	)	
Jehan-Das, Inc.,	)	Case No.
	)	81-03244-S-2-11
	)	(Filed
Debtor.	)	October 17, 1988)

MEMORANDUM OPINION

FACTS

Jehan-Das, Inc., filed a voluntary petition under Chapter 11 of the Bankruptcy Code on October 20, 1981. The corporation continued to do business as a debtor-in-possession. No plan was ever confirmed. Due to the debtor's inability to reorganize, business operations ceased during 1984 and the estate was ultimately liquidated.

During the Chapter 11 proceedings, the debtor failed to pay post-petition, employment related taxes. Pursuant to a court order allowing the filing of

claims, the Internal Revenue Service (IRS) filed a Request For Payment of Internal Revenue Taxes dated December 17, 1987, showing a total of $148,078.63 including interest and penalties, in unpaid withholding, FICA and FUTA taxes which accrued subsequent to the filing of the Chapter 11 petition. The IRS Request for Payment also states additional late payment penalties after the date of said request accruing at the rate of $609.73 per month. For the nine months following the date of the filing of said request an additional $5,451.57 is due. Total taxes, interest, penalty and late charges are, therefore, $153,530.20.

The amounts for Withholding and FICA taxes have been assessed personal against the corporate president, John Royal, as a 100% penalty pursuant to 26

U.S.C. Section 6672. John Royal was personally assessed liability for $36,111.23 for the taxable quarters ending December 31, 1981, through June 30, 1983 and a similar assessment was made on December 7, 1987, in the amount of $9,142.79, for the unpaid employees' portion of the debtor's employment tax liabilities for the taxable quarters ending September 30, 1983, through June 30, 1984. The IRS has filed a notice of tax lien for the trust fund portion of the corporate taxes assessed against John Royal in Tulsa County, Oklahoma.

The debtor has filed a Motion to dismiss and has requested that the funds on hand be paid to the IRS with directions to apply the proceeds from the sale of estate assets first to the trust fund portion of the Withholding and FICA taxes due. If the debtor's

motion is granted, the provision for the allocation of the payment of tax claims would operate to reduce the amount of collectible from John G. Royal, personally to the extent the tax payments are actually made by the debtor.

LAW

"Trust Fund" Taxes

Under the Federal Insurance Contributions Act, 26 U.S.C. Section 3101, et seq., and the federal income tax laws, 26 U.S.C. Section 3401, et sequ., employers are required to withhold federal income and Federal Insurance Contributions Act (FICA) taxes from the wages paid to their employees and to pay the amounts withheld to the Internal Revenue Service on at least a quarterly basis. 26 U.S.C. Sections 3102(a), 3402(a). Pursuant to 28 U.s.C.

Section 7501(a) of the Internal Revenue Code of 1986, the amounts so withheld are deemed to be held in trust for the benefit of the United States, Kizzler v. United States, 598 F.2d 1128 (8th Cir. 1972), and thus are often referred to as "trust fund" taxes. Slodov v. United States, 436 U.S. 238, 98 S.Ct. 1778, 1783, 56 L.Ed.2d 251 (1978). If the employer withholds these taxes but fails to pay them over to the United States, the employee is nevertheless credited with having paid the taxes, and the government may not require any additional payment from the employees. Thus, unless the government has recourse against the person responsible for the collection and non-payment of the taxes, the revenues are lost to the government. Slodov v. United States, 436 U.S. 238, 243 (1978); Maggy v. United States, 560

F.2d 1372 (9th cir. 1977), cert denied, 439 U.S. 821, 99 S.Ct. 86, 58 L.Ed.2d. 112 (1978); Emshwiller v. United States, 565 F.2d 1042, 1044 (8th Cir. 1977).

In order to maximize tax revenues, Congress has imposed personal liability on the corporate officers and directors who are "responsible persons" for the collection and payment of "trust fund" taxes. See Matter of Ribs-R-Us, Inc., 828 F.2d 199 (3rd Cir. 1987); Matter of A & B Heating and Air Conditioning, 823 F.2d 462 (11th Cir. 1987), vac'd and rem'd for consideration of mootness question, 108 S.Ct. 1724, 100 L.Ed.2d 189 (1988); In re Technical Knockout Graphics, Inc., 833 F.2d 797 (9th Cir. 1987). Section 6672 provides that "[a]ny person required to collect, truthfully account for, and pay over any tax *** who wilfully fails to collect

such tax, or truthfully account for and pay over such tax" shall be personally liable to the United States for the full amount of the taxes not collected or paid to the United States. The unpaid trust fund taxes are only collected once by the Internal Revenue Service, whether collected in part or in whole from each responsible person and/or the corporate employer. See, USLIFE Title Insurance Co. v. Harbison, 784 F.2d 1238, 1243 (5th Cir. 1986).

If the Debtor were allowed to designate the allocation of payments, it would no doubt require the IRS to apply its tax payments first to the trust fund portion of its tax liabilities in order to reduce the individual's personal liability. The IRS on the other hand, would like the payments to apply first to the non-trust fund taxes due the

government because this method of collection increases the government's opportunity to recover in full the taxes due by giving it an additional source for collection of the trust fund taxes (the responsible party), and in fact, this is the IRS stated policy. In re Technical Knockout Graphics, Inc., supra at 799; In re Ribs-R-Us, supra at 201; Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983); United States v. DeBeradinis, 395 F.Supp. 944, 952 (D.Conn. 1975), aff'd, 538 F.2d 315 (2d Cir. 1976). See, Policy Statement P-5-60, IRS Manual (May 30, 1984). This policy is consistent with the purpose of Section 6672 liability -- to encourage responsible persons to withhold the taxes that are collected from employees' wages in trust and to see that the withheld taxes are paid over to the

government when they are due. It is also consistent with the purpose of the rule allowing a debtor to designate application of a payment only when he makes a voluntary payment -- to encourage debtors to make voluntary payments. In re Avildsen Tools & Machine, Inc., 794 F.2d 1248, 1251 (7th Cir. 1986); Muntwyler v. United States, supra at 1032.

Voluntary or Involuntary

The crucial distinction in determining whether the taxpayer has the right to direct allocation of tax payments to certain tax liabilities is whether the payment is "voluntary" or "involuntary". In general, when a taxpayer submits a voluntary payment to the IRS, he is entitled to designate the tax liability to which the payment will

be applied. In re Technical Knockout Graphics, Inc., supra at 799; In re Ribs-R-Us, Inc., supra at 201; Muntwyler v. United States, supra at 1032; In re Professional Technical Services, Inc., 80 B.R. 157 (Bkrtcy. E.D.Mo. 1987). This rule is in accord with the rule generally recognized between creditors and debtors, that the debtor may indicate which debt he intends to pay when he voluntarily submits a payment to his creditor, but may not dictate the application of funds that the creditor involuntarily collects from him. See, National Bank of the Commonwealth v. Mechanic's National Bank, 94 U.S. 437 (1877); Muntwyler v. United States, supra at 1032; O'Dell v. United States, 326 F.2d 451, 456 (10th Cir. 1964). In the absence of a designation or agreement as to how tax payments are to

be applied, the IRS may apply the payment received against any amount owed as it sees fit. In re Tom LeDuc Enterprises, Inc., supra at 902; United States v. DeBeradinis, supra; In re B & P Enterprises, Inc., 67 B.R. 179, 182 (Bkrtcy. W.D. Tenn. 1986).

The cases have uniformly adopted the definition of involuntary payments enunciated in Amos v. Commissioner, 47 T.C. 65, 69 (1966). It provides that:

> An involuntary payment of federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the government is seeking to collect its delinquent taxes or file a claim therefore.

Voluntariness is not solely determined by the presence of administrative

action,[1] "but rather the presence of court action or administrative action resulting in an actual seizure of property or money as in a levy". Muntwyler v. United States, supra at 1033. (emphasis in original). The slightest actions to collect taxes, such as filing a claim, or telephoning or writing the debtor to inform him of

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[1]The Court in Muntwyler v. United States, supra at 1032-33 defined involuntary payment as "one made pursuant to judicial action or some form of administrative seizure."; See also, In re Mister Marvins, Inc., 48 B.R. 279, 281 (E.D. Mich. 1984) (distinction between voluntary and involuntary payment is existence or non-existence of some form of court action); United States v. DeBeradinis, supra at 952 (holding that payments were involuntary when "they resulted from Internal Revenue levies or participation in litigation"); Monday v. United States, 342 F.Supp. 1271, 1275 (E.D. Wis. 1972), aff'd, 478 F.2d 1404 (7th Cir. 1973), cert denied, 400 U.S. 910, 94 S.Ct. 233, 38 L.Ed.2d 148 (1973); In re Obie Elie Wrecking Co., 35 B.R. 114 (Bkrtcy. N.D. Ohio 1983).

taxes due, do not in themselves make a payment involuntary. Id.

The circuit courts differ on how payments made in bankruptcy are viewed.[2] Some courts follow the view that all payments made in bankruptcy are involuntary, and therefore the debtor is unable to designate the allocations of the funds. In re Technical Knockout Graphics, Inc., supra[3] (tax payment made

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[2]Courts in general disagree on whether payments made to the IRS by a debtor in bankruptcy may be allocated to pay one debt or another. For a list of cases regarding this subject see, Matter of A & B Heating and Air Conditioning, 823 F.2d 462, 463, n.2 (11th Cir. 1987); In re Technical Knockout Graphics, Inc., 833 F.2d 797, 802, n. 1 (9th Cir. 1987).

[3]The court in this case stated that payments made by a debtor in possession after filing a petition for reorganization under Chapter 11, but prior to confirmation of a reorganization plan, are involuntary and the bankruptcy court does not even have equitable jurisdiction to order otherwise. Id., at 802.

by debtor after filing voluntary Chapter 11 petition, but prior to confirmation of reorganization plan, involuntary); In re Ribs-R-Us, Inc., supra, (payments to confirmed plan of reorganization are involuntary); and In re DuCharmes & Co., 852 F.2d 194 (6th Cir. 1988). The basis for these decisions rests on the debtor's lack of control of payments after he has filed bankruptcy and of the administrative, court-controlled nature of the disbursement of a debtor's funds. these cases state that, because of the last--resort nature of bankruptcy, it is exactly the type of action which under Amos should be considered involuntary, especially where the debtor liquidates its assets merely using bankruptcy as a vehicle for allowing such liquidation to be done in an orderly manner.

Another court says payments in bankruptcy made pursuant to a plan or reorganization are always voluntary. In re Professional Technical Services, Inc., 80 B.R. 157 (Bkrtcy. E.D.Mo. 1987). The court in this case, recognized that although debtors in bankruptcy are restricted, Chapter 11 offers them a full spectrum of opportunities for creditor treatment.

And still other courts maintain that whether payments made during bankruptcy are voluntary or involuntary depends on the totality of the circumstances and should be left to judicial discretion. In re A & B Heating & Air Conditioning, inc., supra. In In re A & B Heating & Air Conditioning, Inc., supra, the Court set out some factors to consider when determining whether payments made during

the pendency of a bankruptcy are voluntary or involuntary. Citing In re B & P Enterprises, Inc., supra, the Eleventh Circuit held that in making this determination the bankruptcy court is to consider the following factors:

1. The history of the debtor.

2. The absence or existence of pre-bankruptcy collection or enforced collection measures of the IRS against the corporation and responsible corporate officers.

3. The nature and contents of a Chapter 11 plan (e.g., last resort liquidation or reorganization).

4. The presence, extent and nature of administrative and/or court actions.

5. The presence of pre-bankruptcy or post-bankruptcy agreements

between the debtor (or trustee) and the IRS.

6. The existence of exceptional or special circumstances or equitable reasons warranting such allocation.

See also, Hineline v. Household Finance Corp, 72 B.R. 642 (N.D. Ohio 1987).

Although the bankruptcy court in the Eastern District of Missouri in In re Professional Technical Services, Inc., 80 B.R. 157 (Bkrtcy. E.D.Mo. 1987), held that payments in bankruptcy are always voluntary, this Court is bound by the District Court decision in In re Tom Leduc Enterprises, Inc.. 47 B.R. 900, 902 (W.D.Mo. 1984). The Court in that case followed the view that the determination of whether payments are made voluntarily or not is to be decided by a review of all the circumstances.

In re Tom LeDuc Enterprises, Inc., 47 B.r. 900, 902 (W.D.Mo. 1984). Although the Court in that case relied heavily upon an agreement between the debtor and the IRS to find that the payments in questions were voluntary, the court stated that the determination of whether a payment is voluntary or not involves an "examination of the specific facts of each case not just an examination of whether or not the payment was made while the payee was in bankruptcy." Id., at 902, relying on, In re Avildsen Tools and Machines, 30 B.R. 911, 917 (Bkrtcy. N.D.Ill. 1983) which was later reversed due to breach of bankruptcy settlement by the debtor. It is this Court's view that such factors do not determine whether a debtor "deserves" to be allowed to designate payments to the IRS, but rather finds these factors to

be determinative of whether the payments are voluntary or involuntary. cf. In re Professional Technical Services, inc., 80 B.R. 157, 159-60 (Bkrtcy. E.D.Mo. 1987).

Discussion

There has been no levy, distraint or actual seizure of funds by the IRS in this case; nor has there been an agreement between the IRS and the corporate debtor or John Royal regarding payment of these taxes. However, the estate has been liquidated and no plan has been confirmed. Additionally, debtor has failed to demonstrate any exceptional or special circumstances or equitable reasons warranting allocation of its payments to the IRS (release of the responsible person's liability is not a circumstance warranting such allocation).

One additional factor influences this Court's decision herein. The debtor's property at the commencement of the case, as well as certain funds acquired by the debtor after bankruptcy, become property of the estate. 11 U.S.C. Section 541(e). The debtor-in-possession is not free to deal with this property as he chooses, but holds it in trust for the benefit of creditors standing in the shoes of a trustee "in every way". S.Rep. No. 95-989, 95th Cong., 1st Sess. at 116, reprinted in [1978] 5 U.S. Code Cong.& Ad, News 5787, 5902; 11 U.S.C. Section 1107. Upon the filing of a petition in Chapter 11, the debtor-in-possession assumes the duties of a trustee, 11 U.S.C. Section 1107, and thus has the status of a fiduciary for the benefit of creditors. See Wolf

v. Weinstein, 372 U.S. 633, 649-50, 83 S.Ct. 969, 979-80, 10 L.Ed.2d 33 (1963).

If Royal designates funds be paid to eliminate his liability first, he is breaching his fiduciary duty, as debtor-in-possession, to the debtor corporation. The best interest of the corporation would be to apply the funds to its non-trust fund liability first, leaving the IRS an alternative source for the trust fund debt. Royal is acting in his fiduciary capacity for the corporation and thus he has a conflict of interest between his own interest (reducing his personal liability) and the corporation's interest (having an alternate source to pay off its debts). Because of this conflict, this Court finds it inappropriate for Royal, individually, to be making the designation of payments for the

corporate debtor, where there has never been a plan confirmed and other parties in interest have never been advised of debtor's intention and desire to extricate its former principal.

For these reasons, this Court determines that payments made by the debtor to the IRS are involuntary in this case and, therefore, the IRS may decide how the payments will be allocated and the debtor will not be allowed to direct the payments.

SO ORDERED this 17 day of October, 1988.

The foregoing constitutes Findings of Fact and Conclusions of Law a required by Rule 7052, Rules of Bankruptcy.

Frank W. Koger
Bankruptcy Judge

Copy of the above mailed to:

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APPENDIX D

TITLE 26

INTERNAL REVENUE CODE

SUBTITLE C--EMPLOYMENT TAXES

Section 3102. Deduction of tax from wages

(a) Requirement.--The tax imposed by section 3101 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. An employer who in any calendar quarter pays to an employee cash remuneration to which paragraph (7)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar quarter is less than $50; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (7)(C) or (10) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $100; and an employer who in any calendar year pays to an employee cash remuneration to which paragraph (8)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax from any such payment of remuneration, even though at the time of

payment the total amount of such remuneration paid to the employee by the employer in the calendar year is less than $150 and the employee ha not performed agricultural labor for the employer on 20 days or more in the calendar year for cash remuneration computed on a time basis; and an employer who is furnished an employee a written statement of tips (received in a calendar month) pursuant to section 6053(a) to which paragraph (12)(B) of section 3121(a) is applicable may deduct an amount equivalent to such tax with respect to such tips from any wages of the employee (exclusive of tips) under his control, even though at the time such statement is furnished the total amount of the tips included in statements furnished to the employer as having been received by the employee in such calendar month in the course of his employment by such employer is less than $20.

Section 3401. Definitions

(a) Wages.--For purpose of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall be include remuneration paid--

(1) for active service performed in a month for which such employee is entitled to the benefits of section 112 (relating

to certain combat pay of members of the Armed Forces of the United States); or

(2) for agricultural labor (as defined in section 3121(g) unless the remuneration paid for such labor is wages (as defined in section 3121(a); or

(3) for domestic service in a private home, local college club, or local chapter of a college fraternity or sorority; or

(4) for service not in the course of the employer's trade or business performed in any calendar quarter by an employee, unless the cash remuneration paid for such service is $50 or more and such service is performed by an individual who is regularly employed by such employer to perform such service. For purposes of this paragraph, an individual shall be deemed to be regularly employed by an employer during a calendar quarter only if--

(A) on each of some 24 days during such quarter such individual performs for such employer for some portion of the day service not in the course of the employer's trade or business; or

(B) such individual was regularly employed (as determined under subparagraph

(A)) by such employer in the performance of such service during the preceding calendar quarter; or

(5) for services by a citizen or resident of the United States for a foreign government or an international organization; or

(6) for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary; or

[(7) Repealed. Pub.L. 89-809, Title I, Section 103(k), Nov. 13, 1966, 80 Stat. 1554.]

(8)(A) for services for an employer (other than the United States or any agency thereof)--

(i) performed by a citizen of the United States, if at the time of the payment of such remuneration, it is reasonable to believe that such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under section 911; or

(ii) performed in a foreign country or in a possession of the United States by such a citizen, if, at the time of the payment of such remuneration, the

employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration; or

(B) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within a possession of the United States (other than Puerto Rico), if it is reasonable to believe that at least 80 percent of the remuneration to be paid to the employee by such employer during the calendar year will be for such services; or

(C) for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States within Puerto Rico, if it is reasonable to believe that during the entire calendar year the employee will be a bona fide resident of Puerto Rico; or

(D) for services for the United States (or any agency thereof) performed by a citizen of the United States within a possession of the United States to the extent the United States (or such agency) withholds taxes on such remuneration pursuant to an agreement with such possession; or

(9) for services performed by a duly ordained, commissioned, or

licensed minister of a church in the exercise of his ministry or by a member of a religious order in the exercise of duties required by such order; or

(10)(A) for services performed by an individual under the age of 18 in the delivery or distribution of newspapers or shopping news, not including delivery or distribution to any point for subsequent delivery or distribution; or

(B) for services performed by an individual in, and at the time of, the sale of newspapers or magazines are to be sold by him at a fixed price over the compensation being based on the retention of the excess of such price over the amount at which the newspapers or magazines are charged to him, whether or not he is guaranteed a minimum amount of compensation for such services, or is entitled to be credited with the unsold newspapers or magazines turned back; or

(11) for services not in the course of the employer's trade or business, to the extent paid in any medium other than cash; or

(12) to, or on behalf of, an employee or his beneficiary--

(A) from or to a trust described in section 401(a) which is exempt from tax under

section 501(a) at the time of such payment unless such payment is made to any employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust; or

(B) under or to an annuity plan which, at the time of such payment, is a plan described in section 403(a); or

(C) for a payment described in section 402(h)(1) and (2) if, at the time of such payment, it is reasonable to believe that the employee will be entitled to an exclusion under such section for payment; or

(13) pursuant to any provision of law other than section 5(c) or 6(1) of the Peace Corps Act, for service performed as a volunteer or volunteer leader within the meaning of such Act; or

(14) in the form of group-term life insurance on the life of an employee; or

(15) to or on behalf of an employee if (and to the extent that) at the time of the payment of such remuneration it is reasonable to believe that a corresponding deduction is allowable under

section 217 (determined without regard to section 274(n); or

(16)(A) as tips in any medium other than cash;

(B) as cash tips to an employee in any calendar monthly, in the course of his employment by an employer unless the amount of such cash tips is $20 or more;

(17) for service described in section 3121(b)(20);

(18) for any payment made, or benefit furnished, to or for the benefit of an employee if at the time of such payment or such furnishing it is reasonable to believe that the employee will be able to exclude such payment or benefit from income under section 127 or 129;

(19) any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe that the employee will be able to exclude such benefit from income under section 74(c), 117, or 132; or

(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6);

Section 6672. Failure to collect and pay over tax, or attempt to evade or defeat tax

(a) General rule.--Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax, or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over. No penalty shall be imposed under section 6653 or part II of subchapter A of chapter 68 for any offense to which this section is applicable.

Section 7501. Liability for taxes withheld or collected

(A) General rule.--Whenever any person is required to collect or withhold any internal revenue tax from any other person and to pay over such tax to the United States, the amount of tax so collected or withheld shall be held to be a special fund in trust for the United States. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

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(2)

No. 90-1709

Supreme Court, U.S.
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In the Supreme Court of the United States

OCTOBER TERM, 1990

JEHAN-DAS, INC., PETITIONER

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the bankruptcy court properly denied petitioner's request to allocate a liquidating distribution under Chapter 11 of the Bankruptcy Code to the "trust fund" portion of petitioner's federal tax liabilities.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A2 to A7) is reported at 925 F.2d 237. The opinion of the district court (Pet. App. B4 to B21) is unreported. The opinion of the bankruptcy court (Pet. App. C4 to C26) is reported at 91 Bankr. 542.

JURISDICTION

The judgment of the court of appeals was entered on February 1, 1991. The petition for a writ of certiorari was filed on May 1, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner filed for reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C.) on October 20, 1981.

Petitioner continued to operate its business as debtor in possession until 1984, when it ceased operations. A plan of reorganization was not filed, and petitioner was eventually liquidated within the Chapter 11 proceedings.

While operating as debtor in possession, petitioner failed to pay both "trust fund" taxes and "non-trust fund" taxes to the government (Pet. App. C5). "Trust fund" taxes are those income and social security taxes that an employer is required to withhold from the wages of employees and pay over to the government. If the persons responsible to collect, account for, and pay over trust fund taxes willfully fail to do so, they are personally liable for a penalty in the amount of the unpaid "trust fund" taxes. See 26 U.S.C. 6672. The Internal Revenue Service determined that petitioner's president, John Royal, was a "responsible officer" who willfully failed to pay over the trust fund taxes to the government. The Service therefore assessed a penalty against Royal in an amount equal to those taxes pursuant to 26 U.S.C. 6672 (Pet. App. C6).

At the time of liquidation, petitioner owed approximately $148,000 for "trust fund" and "non-trust fund" taxes (Pet. App. C5). Petitioner did not dispute that the government's claim for these taxes was entitled to priority and that the funds in the estate (approximately $59,000) were insufficient to pay the claim in full. Petitioner did, however, request the bankruptcy court to direct the IRS to apply the liquidation distribution first to the "trust fund" portion of the taxes owed. As petitioner acknowledges (Pet. 6), the sole purpose for such an application would be to decrease Royal's personal liability under Section 6672. The IRS collects the full amount of the "trust fund" liability only once, whether payment is first received from the corporation or from the responsible person. See *USLIFE Title Insurance Co.* v. *Harbison*, 784 F.2d 1238, 1243 (5th Cir. 1986). The IRS, however, applies payments first to a debtor's "non-trust

fund" liability, thereby preserving its right to pursue the responsible person in the event of a shortfall to enhance the prospect of eventually being made whole. See *United States* v. *Energy Resources Co.*, 110 S. Ct. 2139, 2143 (1990). The IRS honors a taxpayer's designation of payments among various taxes due *only* where the payment is voluntary. See Rev. Rul. 73-305, 1973-2 Cum. Bull. 43, modified by Rev. Rul. 79-284, 1979-2 Cum. Bull. 83.

On October 17, 1988, the bankruptcy court issued its memorandum opinion holding that the liquidating distribution was not "voluntary" and that petitioner therefore could not designate how the distribution should be applied by the IRS. The court determined whether the payment was voluntary by reviewing all of the circumstances (Pet. App. C20-C25). The court noted that petitioner had been liquidated and that no agreement had been reached between petitioner and the IRS concerning payment of either the "trust fund" or "non-trust fund" taxes (*id.* at C22). The court also noted that petitioner, as debtor in possession, was "not free to deal with this property as he chooses, but holds it in trust for the benefit of creditors" (*id.* at C23). In seeking to designate the payment of taxes to be applied first against the "trust fund" liability, petitioner was not acting for the benefit of its creditors but was acting only for the benefit of Royal, its president (*id.* at C24). Under these circumstances, the court found the payment to be involuntary (*id.* at C25). The district court affirmed (Pet. App. B2-B3).

2. The court of appeals also affirmed. The court stated that "[t]here is no bright line identifying payments to the IRS as voluntary or involuntary." Pet. App. A5. After examining the specific facts of this case—including that petitioner had liquidated its assets under the control and supervision of the bankruptcy court; that it could not distribute those funds without court approval; that the court had

already ordered petitioner to pay the IRS; and that the bankruptcy case could not be closed until petitioner made the payment (*id.* at A6)—the court concluded that petitioner had no choice but to pay the funds to the IRS and that the payment was therefore not voluntary (*ibid.*).

ARGUMENT

The court of appeals correctly held that the liquidating distribution from petitioner's estate was not a voluntary payment of taxes. The decision of the court of appeals does not conflict with any decision this Court or of the other courts of appeals. Further review is therefore not warranted.

1. It is the long-standing policy of the Internal Revenue Service that, when a payment is voluntarily made, the IRS will accede to the taxpayer's request that the payment be applied to a specific portion of the taxpayer's tax liability. See, *e.g.*, *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 227 (1st Cir. 1989), aff'd, 110 S. Ct. 2139 (1990). In this case, the court of appeals held, after examining the relevant factors, that the distribution was not a voluntary payment. The court noted that petitioner had liquidated its assets under the control and supervision of the bankruptcy court, that the bankruptcy court had ordered that the federal taxes be paid, and that the case could not be closed until the funds were distributed. The bankruptcy court also noted that any designation of the funds would be for the sole benefit of petitioner's president, who would have his personal tax liability reduced, and not for the benefit of petitioner's creditors, in whose best interest petitioner (as debtor in possession) was required to act. Under these circumstances, the court correctly held that the liquidating distribution was not voluntary and that petitioner therefore could not direct the IRS how to apply the payment.

2. This decision does not conflict with the decision of any other court of appeals. Indeed, the courts uniformly

have held that a debtor has no right to direct the application of tax payments in a Chapter 11 proceeding because such payments are involuntary. *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 230 (1st Cir. 1989); *DuCharmes & Co.* v. *Michigan*, 852 F.2d 194, 196 (6th Cir. 1988); *United States* v. *Technical Knockout Graphics, Inc.*, 833 F.2d 797, 802 (9th Cir. 1987); *In re Ribs-R-Us, Inc.*, 828 F.2d 199, 202-203 (3d Cir. 1987).[1] Thus, contrary to petitioner's contentions (Pet. 7-16), there is no conflict among the circuits on the issue addressed and resolved in this case.

Petitioner further contends (Pet. 11-16), however, that the courts of appeals are divided in their method of analysis of the question whether a tax payment by a Chapter 11 debtor is voluntary. According to petitioner (Pet. 11-14), the First and Eleventh Circuits use a "case by case" approach, the Third, Sixth and Ninth Circuits have adopted a rule that such payments are involuntary per se, and the court of appeals here found an unspecified middle ground. Petitioner apparently favors the formulation of a "bright line" (Pet. 18), although it takes issue with the placement of that line by the courts of appeals that have drawn one.

The short answer to petitioner's conflict-in-approach argument is that each of the decisions that has addressed the question has held that payments by a debtor in Chapter

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[1] The only contrary appellate decision (*United States* v. *A & B Heating & Air Conditioning, Inc.*, 823 F.2d 462, 465 (11th Cir. 1987)) was vacated by this Court and remanded for consideration of mootness. 486 U.S. 1002 (1988). The debtor in that case moved to delete the provision in its Chapter 11 plan designating how the taxes were to be applied, and the court of appeals ordered the case to be dismissed as moot. 878 F.2d 1311 (11th Cir. 1989). The case therefore lacks any precedential value. See *County of Los Angeles* v. *Davis*, 440 U.S. 625, 634 n.6 (1979).

11 are involuntary.[2] Even if the circuits have employed differing modes of analyses with respect to the question presented by this case, petitioner would not prevail under any of them.

3. Petitioner errs in contending (Pet. 20) that the decision of the court of appeals conflicts with this Court's holding in *United States* v. *Energy Resources Co.*, 110 S. Ct. at 2142, that bankruptcy courts have broad authority to modify debtor-creditor relationships in approving Chapter 11 plans. In *Energy Resources*, the Court held that bankruptcy courts in a Chapter 11 case may direct the manner in which tax payments are applied by the IRS when such an allocation is "necessary for the success of a reorganization plan." 110 S. Ct. at 2140. See *id.* at 2142, 2143. The present case, however, does not involve a question of the bankruptcy court's authority nor a question of the imperatives of a plan of reorganization. This proceeding arises from a liquidation of the debtor's assets, not a reorganization. Moreover, the bankruptcy court denied petitioner's proposed allocation specifically because it represented an abuse of the fiduciary obligations petitioner owed to its creditors. The decision of the court of appeals is thus entirely consistent with this Court's decision in *Energy Resources*.

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[2] Petitioner also suggests (Pet. 15-16) that the decision in this case conflicts with the Seventh Circuit's decision in *Muntwyler* v. *United States*, 703 F.2d 1030 (1983). But as petitioner acknowledges elsewhere (Pet. 10), the *Muntwyler* court specifically refused to equate the nonjudicial assignment for the benefit of creditors before it in that case with a proceeding under the Bankruptcy Code. The court specifically distinguished the two situations, noting that "[t]he Government might have been correct in its claim [that the tax payment was involuntary] if the corporation had been in bankruptcy, which it was not." 703 F.2d at 1034 n.2.

CONCLUSION

The petition for a writ of certiorari should be denied.
Respectfully submitted.

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